Supreme Court, U.S.
FILED
JUL 7 1994
OFFICE OF THE CLERK

No. 93-1974

In The

Supreme Court of the United States

October Term, 1994

ROGER W. TRACY,
TAX COMMISSIONER OF OHIO,

Petitioner,

v.

MCI TELECOMMUNICATIONS CORPORATION,

Respondent.

On Petition For Writ Of Certiorari
To The Supreme Court Of Ohio

BRIEF OF *AMICI CURIAE* CITY OF NORTH ROYALTON AND NORTH ROYALTON CITY SCHOOL DISTRICT BOARD OF EDUCATION IN SUPPORT OF PETITIONER'S PETITION FOR WRIT OF CERTIORARI

MARK A. ENGEL
[redacted]
SYLVIA LYNN GILLIS
BRICKER & ECKLER
100 South Third Street
Columbus, Ohio
43215-4291
(614) 227-2327

DENNIS RADEMAKER
PETRO, RADEMAKER, MATTY
& MCCLELLAND
55 Public Square,
Suite 1775
Cleveland, Ohio 44113
(216) 621-6570

DENNIS RADEMAKER
LAW DIRECTOR
City of North Royalton
55 Public Square,
Suite 2240
Cleveland, Ohio 44113
(216) 861-3610

Attorneys for Amici Curiae City of North Royalton and North Royalton City School District Board of Education

RECEIVED
JUL - 8 1994
OFFICE OF THE CLERK
SUPREME COURT, U.S.

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

20 pp

QUESTIONS PRESENTED FOR REVIEW

I. WHETHER A STATE VIOLATES THE EQUAL PROTECTION CLAUSE WHEN IT DRAWS A RATIONAL CLASSIFICATION AMONG TAXPAYERS FOR TAX AND REVENUE PURPOSES THAT DIFFERS FROM THE DISTINCT CLASSIFICATIONS THE STATE HAS DRAWN ABOUT THOSE SAME PERSONS FOR REGULATORY OR OTHER PURPOSES UNDER THE STATE'S POLICE POWERS.

II. WHETHER A COURT CAN PROPERLY FIND A VIOLATION OF THE EQUAL PROTECTION CLAUSE BY IGNORING PLAUSIBLE POLICY REASONS THAT SUPPORT A STATE'S RATIONAL TAX CLASSIFICATION, RELYING SOLELY ON THEORETICAL DISCRIMINATION THAT IS NOT SHOWN TO HAVE ACTUALLY OCCURRED, AND ABSENT ANY INVIDIOUS DISCRIMINATION OR BAD FAITH ACTIONS BY STATE OFFICIALS.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED FOR REVIEW i

TABLE OF AUTHORITIES iii

STATEMENT OF THE CASE 1

INTEREST OF *AMICI CURIAE* 2

SUMMARY OF THE ARGUMENT 4

ARGUMENT 5

I. STATES HAVE BROAD DISCRETION IN DEVISING A REASONABLE STATE TAX SYSTEM. A TAXPAYER CHALLENGING A TAX CLASSIFICATION ON EQUAL PROTECTION GROUNDS MUST NOT ONLY NEGATE EVERY CONCEIVABLE BASIS UPHOLDING THE CLASSIFICATION, BUT MUST ALSO PROVE THE EXISTENCE OF ACTUAL DISCRIMINATION, BEFORE THE SYSTEM WILL BE STRUCK DOWN AS VIOLATIVE OF FEDERAL EQUAL PROTECTION 5

A. The Ohio Court Failed to Determine Whether Any Rational Basis Existed for the Distinction Between Facility-Based Carriers and Resellers 6

B. The Court Below Failed to Find That Any Discrimination Occurred in Fact 8

C. The Impact of the Decision of the Court Below Will Adversely Affect in a Profound Manner both *Amici Curiae* City of North Royalton and North Royalton City School District Board of Education 9

CONCLUSION 15

TABLE OF AUTHORITIES

Page

CASES

Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522 (1959) 5, 6

Bell's Gap Railway Co. v. Pennsylvania, 134 U.S. 232 (1890) 5

Carmichael v. Southern Coal & Coke Co., 301 U.S. 495 (1937) 6, 7

Madden v. Kentucky, 309 U.S. 83 (1940) 6, 8

Nordlinger v. Hahn, 505 U.S. ___, 112 S. Ct. 2326 (1992) 6

Roberts & Shaffer Co. v. Emmerson, 271 U.S. 50 (1926) 9

STATUTES

Ohio Rev. Code Section 5727.01(A) 10

Ohio Rev. Code Section 5727.01(E)(2) 10

STATEMENT OF THE CASE

This matter arises out of an administrative appeal by Respondent with respect to its 1987 Ohio public utility property tax return. Upon the assessment and apportionment of the value of its property by Petitioner, Respondent claimed that its property should be taxed as a general property taxpayer (at 31% of its true value) rather than as a telephone company (at 100% of its true value). Respondent further claimed that its property should be apportioned differently than in previous years. Petitioner denied the claims and Respondent appealed to the Ohio Board of Tax Appeals ("BTA").

Before the BTA, Respondent pressed its two original claims. For the first time, it also raised a constitutional argument. Respondent claimed that since resellers were regulated in the same manner as facility-based carriers, they must be taxed as facility-based carriers. However, the policy of Petitioner is to assess the property of resellers as general property taxpayers. Respondent claimed that this disparity in treatment denied to it equal protection of the laws. It presented no evidence indicating that the statutory scheme upon which the policy was based was not founded upon some rational basis, nor did it demonstrate in fact that any reseller, if any existed, was treated differently for the 1987 tax year. The BTA agreed with Respondent with respect to the apportionment issue and, as an administrative agency without authority to do so, declined to rule on the constitutional issue.

Both parties appealed to the Ohio Supreme Court. Even though plausible reasons were suggested, that court failed to consider whether any rational basis existed to

support the different treatment of resellers and facility-based carriers for tax purposes or to consider whether any discrimination had in fact occurred. Instead, it reasoned that since facility-based carriers and resellers were subject to the same type of rate and reporting regulation by the Ohio Public Utilities Commission, they were members of the same class for tax purposes. Following the denial of a motion for rehearing, Petitioner filed its petition with this Court.

Amici first became involved in the litigation before the BTA, where they attended the hearing but did not participate. Administrative proceedings before Petitioner are confidential, and there is no formal mechanism for making affected taxing districts a party when a property tax matter is appealed to the BTA. *Amici* filed an amicus brief when the decision of the BTA was appealed to the Ohio Supreme Court.

INTEREST OF *AMICI CURIAE*

Amici curiae City of North Royalton, Ohio and North Royalton City School District Board of Education have a substantial interest in the outcome of this litigation. The majority of Respondent's taxable personal property, the microwave equipment which is the subject of Respondent's claim that the value of its property has been improperly and unfairly assessed and apportioned by the State of Ohio, is located within the City of North Royalton and the North Royalton City School District. Both the City of North Royalton and the North Royalton City

School District Board of Education are recipients of the tax revenues generated by the *ad valorem* taxes imposed upon the property of Respondent and are dependent upon these revenues in the planning of municipal and educational public programs. *Amici curiae* are representative of other governmental entities, including other school districts, throughout the State of Ohio whose operations will be significantly and adversely impaired if the Ohio Supreme Court's finding that the manner used by the Tax Commissioner in assessing the value of Respondent's personal property violated the Equal Protection Clause.

The Ohio Supreme Court made no finding that the classification used by the Tax Commissioner in assessing the value of Respondent's personal property lacked a rational basis; the Ohio court also failed to find in fact that Respondent suffered any invidious discrimination in the assessment of its property. In fact, the court never even considered these issues. Nevertheless, it ordered that Respondent's assessment percentage be reduced from that applied to telephone companies to that used for general business property. In reaching this decision, the Ohio court failed to consider the arguments advanced by Petitioner in support of its assessment procedure. More importantly, it failed to apply the tests enunciated by this Court as applicable in equal protection cases. The result of the implementation of the Ohio court's decision will be devastating for *amici curiae* and other similarly situated local governmental entities and school districts.

SUMMARY OF THE ARGUMENT

Amici curiae respectfully submit that Petitioner's application of the Ohio statutes to Respondent's taxable property for purposes of assessing personal property taxes owing to the State is proper and that the method employed by Petitioner has a rational basis that does not violate the Equal Protection Clause of either the Federal or State Constitution. It is entirely reasonable to distinguish between facility-based carriers, such as Respondent, who own their own integrated systems of transmission equipment through which they conduct their business of transmitting telephonic messages, and buyers and resellers of such services, who do not own their own equipment, but rather contract with others who own the equipment to provide the service.

In addition, there are other plausible reasons for the assessment of Respondent's property at the higher rate applicable to telephone companies. Also, application of the Ohio court's decision, even if determined to be the proper interpretation of federal constitutional law, would have a devastating effect upon local taxing districts in which the personal property of Respondent and other facility-based carriers is located. Thus, the erroneous analysis employed by the Ohio court will have a crippling effect upon local governments and the public education system within the State and will provide to Respondent and other telephone companies an unanticipated tax windfall.

ARGUMENT

I. STATES HAVE BROAD DISCRETION IN DEVISING A REASONABLE STATE TAX SYSTEM. A TAXPAYER CHALLENGING A TAX CLASSIFICATION ON EQUAL PROTECTION GROUNDS MUST NOT ONLY NEGATE EVERY CONCEIVABLE BASIS UPHOLDING THE CLASSIFICATION, BUT MUST ALSO PROVE THE EXISTENCE OF ACTUAL DISCRIMINATION, BEFORE THE SYSTEM WILL BE STRUCK DOWN AS VIOLATIVE OF FEDERAL EQUAL PROTECTION.

The Ohio Supreme Court found that Petitioner's policy of taxing the property of facility-based carriers at a rate higher than resellers and general property taxpayers denied to Respondent the equal protection of the laws. In making that determination, the Ohio court failed to consider whether any conceivable basis existed for the classification. The court also failed to consider in fact whether any discrimination actually occurred. For these reasons, the Ohio court's holding is at odds with the equal protection principles long espoused by this Court. The Ohio court's decision must, therefore, be reviewed and reversed.

This Court has long recognized that states are granted "very wide discretion" in selecting the subjects of taxation and the classifications inherent in the laying of state taxes. *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 526 (1959). There is no iron rule of equality in the field of tax classifications. *Bell's Gap Railway Co. v. Pennsylvania*, 134 U.S. 232, 237 (1890). Even the narrowest of

distinctions may be upheld, so long as there is any possible basis for the distinction between classes. *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 509 (1937).

Moreover, the state has no obligation to state expressly the purpose for which a distinction is made. If there is any conceivable basis for the distinction, it will be upheld. *Nordlinger v. Hahn*, 505 U.S. ___, 112 S. Ct. 2326 (1992). Therefore, the burden is on the party challenging the classification to refute every conceivable basis for the distinction. *Madden v. Kentucky*, 309 U.S. 83, 88 (1940). It must demonstrate discrimination in fact.

A. The Ohio Court Failed to Determine Whether Any Rational Basis Existed for the Distinction Between Facility-based Carriers and Resellers.

A state may resort to fine distinctions for tax classification purposes. *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522 (1959). A classification will be upheld as long as it is not arbitrary and is founded upon a legitimate policy. A state is not required to tax all members of a class or to tax none of the members of the class. *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. at 509. In *Carmichael*, this Court stated that administrative convenience and expense in the collection or measurement of a tax are permissible bases for distinguishing between members of a class. This Court also observed that distinctions may be made to encourage certain economic activities or to discourage others.

In this case, the Ohio court fell short on two accounts. First, it never considered the possible bases for the distinction drawn between facility-based carriers and

resellers. Most obviously, there is a distinct difference between the two entities in terms of the property owned and the activities performed. The record demonstrates that facility-based carriers own an integrated system for the transmitting of telephonic messages, including transmission equipment. Resellers do not; they merely purchase and resell telephone services from facility-based carriers. This difference in fact between the two entities was never considered by the court below.

Moreover, other possible reasons supporting the distinction were offered by Petitioner. Petitioner stated that subjecting resellers to a lower rate of taxation could serve to encourage resellers in order to increase competition and to reduce the costs of long distance telephone service to consumers. As noted in *Carmichael v. Southern Coal & Coke Co., supra,* distinctions designed to encourage some business entities or activities over another are permitted. Another possible basis posited by Petitioner was that facility-based carriers can pass on the higher cost of the tax to a broader range of customers more easily than can resellers.

There is yet another possible basis for the distinction. Distinctions may be based upon administrative convenience and the cost of collecting the tax. For example, in *Carmichael v. Southern Coal & Coke Co.*, this Court upheld a challenge to the classification between employers of eight (8) or more persons and employers of seven (7) or less persons. One of the reasons given for sustaining the classification was the administrative inconvenience of taxing smaller entities that did not yield great amounts of revenue.

The same situation exists here. Facility-based carriers own the largest portion of the property taxed to telephone companies in Ohio. Their transmission systems are massive. Resellers, to the extent they operate in Ohio at all, have very little personal property. The state legislature could have taken this difference into consideration in drafting the legislation in question. The court below made no finding on this point because it failed to consider the issue.

Although these issues were raised, Respondent did not address any of these issues, and the Ohio court did not consider them. Yet, it is a fundamental tenet of equal protection analysis that the party challenging the classification must disprove every conceivable basis for the classification. In failing even to make this analysis, the decision below is contrary to the express and consistent dictates of this Court in the area of equal protection jurisprudence.

B. The Court Below Failed to Find That Any Discrimination Occurred in Fact.

The Ohio court also fell short in assuming that Petitioner's policy of treating resellers differently from facility-based carriers demonstrated actual discrimination to the detriment of Respondent. A denial of equal protection will not be presumed. There must be the most explicit demonstration that a classification results in hostile and oppressive discrimination before it will be struck down. *Madden v. Kentucky, supra.* A challenge may not rest solely

upon theoretical inequalities. *Roberts & Shaffer Co. v. Emmerson*, 271 U.S. 50, 54-55 (1926).

In this case, Petitioner has admitted a policy of differentiation between facility-based carriers and resellers in the area of property taxation. Assuming for the moment that this distinction may be without any rational basis, the Court below still erred in its decision. If there is in fact no discrimination, there is no denial of equal protection. The record in this case is devoid of any evidence that any reseller existed in Ohio in 1987 or had its property taxed in a manner different from Respondent's property. The Ohio court failed to make any inquiry into this subject; it merely assumed that discrimination occurred. This determination is clearly contrary to the settled decisions of this Court on the subject.

This error is significant.

C. The Impact of the Decision of the Court Below Will Adversely Affect in a Profound Manner both *Amici Curiae* City of North Royalton and North Royalton City School District Board of Education.

Public utility personal property taxes, including those of telephone companies, assessed by the Tax Commissioner are apportioned among the individual taxing districts throughout the State of Ohio based upon the value of the public utility's property located in each taxing district. The Tax Commissioner has reasonably found Respondent to be a telephone company, and therefore a public utility, for purposes of assessing personal property taxes owing to the State of Ohio based upon a

plain reading of Ohio Rev. Code Sections 5727.01(A) and 5727.01(E)(2).

Respondent has even categorized itself as a public utility when seeking benefits from the City of North Royalton for the location of its microwave facilities. Respondent repeatedly represented to the City of North Royalton, as early as 1972 when its initial microwave tower was erected and as recently as 1988 when it sought to expand its facility, that it was a public utility. Based on the City of North Royalton's finding that Respondent was in fact a public utility, the City authorized the construction and expansion of Respondent's telephone facilities in a residential area where, but for Respondent's status as a public utility, the facilities would not otherwise have been permitted. It is patently unfair now to allow Respondent to be taxed as other than a public utility when it has benefited greatly from the favorable treatment afforded it by the City of North Royalton on the basis that it was in fact a public utility.

The apportionment method for taxable property of public utilities in Ohio was statutorily established after careful consideration and proper operation of the legislative process. Respondent's personal property subject to taxation by the State of Ohio was and continues to be located in taxing districts throughout the State of Ohio. A change in the assessment process of the drastic nature mandated by the lower court would result in inequities to the local taxing districts that cannot be tolerated.

Local taxing districts rely upon the taxes assessed by the Tax Commissioner upon property located within their borders to fund local government programs, including

public education. The Tax Commissioner has consistently, correctly, and logically interpreted the Ohio statutes defining telephone companies to include facility-based carriers, such as Respondent, for many years. As a result of this interpretation and application of Ohio law to facility-based carriers, local taxing districts include the potential taxes assessed against public utility personal property in their budget planning process. For example, each of the *amici* has committed financial resources to significant activities within its respective district based upon the continued receipt of tax revenues from Respondent's personal property located within the district. The City of North Royalton in October 1990 undertook a bond obligation of $2.6 million for the construction of a police and jail facility; the annual debt service on that bond issue is approximately $250,000.00. The City of North Royalton also authorized $490,000.00 in bonds for the acquisition of real property in July of 1991; the annual debt service on this bond issue is approximately $46,000.00. Neither of these obligations would have been undertaken if the City had any indication that the tax revenues it was currently receiving from the property of Respondent located within the district would cease.

The City's ability to continue to fund these projects, plus repay to Respondent with interest the amounts advanced to date under the assessment procedure found to be unconstitutional by the lower court, is not possible. Application of the decision of the court below will require the City of North Royalton, the North Royalton City School District Board of Education, and all other similarly situated taxing districts, to repay revenue that was spent five years ago and to which they had no reason

to believe they were not entitled. Specifically, the North Royalton City School District Board of Education will be required to refund the approximate amount of $1,250,000.00 per year for a period of five years, plus interest, while the City of North Royalton will be required to refund the approximate amount of $450,000.00 per year for each of the five years in question.

Respondent and other facility-based carriers have similar claims pending for subsequent years. Cities and school districts across the state will be faced with the double whammy of reductions in tax revenues and the making of huge refunds from those decreased resources. The result will be crippling to local government and public education in Ohio.

School districts in Ohio today are facing severe financial crises in meeting the many unfunded mandates with which they are expected to comply and in meeting the ever-increasing costs of existing programs. Any expectation that these school districts would be able to repay funds already spent ignores the realities of the current plight of many Ohio school districts. School districts in large part are barely, and in some instances not even, able to meet the basic educational needs of their students. Buildings and equipment are in poor repair; books are outdated and scarce; supplies are practically non-existent. In this environment, the requirement that these districts repay tax revenues received by them to which they believed they were entitled, which they have already invested in the educational process, and which Respondent has always paid in the past, is patently unfair and should not be allowed to stand.

For example, the value of Respondent's property situated within the North Royalton City School District was certified by the Commission at $15,201,610.00 for tax year 1987. The tax certified for this property for the tax year 1987 was $1,258,693. This figure will be reduced by two-thirds as a result of the erroneous decision of the Ohio court below.

This is by far the largest amount of tax revenue directed to a single district within Ohio for this period of time. Exhibit M to the proceedings below summarizes by individual taxing district in Ohio the value of the assessed personal property tax upon Respondent's taxable property for the year 1987. Taxes as certified range from less than one thousand dollars to over one million dollars. Regardless of the amount to be repaid, any taxing district will undoubtedly have difficulty in repaying amounts advanced over the past five years, plus interest on those amounts, as directed by the court below.

Any considerations given by the Ohio legislature to changing the structure of personal property taxation treatment of different businesses, such as Respondent's, have met with opposition from legislators because of the concern for local revenue and the funding of public education. Approximately seventy percent of all property tax revenue is provided to the school districts. These local tax revenues provide approximately 50% of the revenues available for public education in Ohio. Because of the concern that any change in personal property taxation methods could negatively impact the amounts of personal property tax available to local school districts, any proposed changes in the personal property taxation methodology have been subjected to great scrutiny. The

deposition of the then-Tax Commissioner in the proceedings below demonstrates that one of the basic tenets of the Department of Taxation when reviewing or considering any proposed change in personal property taxation was that there be no loss of revenue to school districts. Although legislation has been introduced at various times that would change the tax scheme to which long distance carriers are subject, such changes have never been enacted because of the concern that there be no revenue reduction to school districts and local governments.

The hardship that will be experienced by the local taxing districts, and in particular school districts, will not be similarly inflicted upon Respondent if the decision below is reversed. Respondent and all other telephone companies have been subjected to the higher personal property tax rate for several years. If the decision below is reversed, Respondent will not be subjected to a higher rate of taxation than in previous years; rather, it will continue to be taxed as it has in years past. Moreover, as a regulated entity, Respondent was able to, and will continue to be able to, set its rates and conduct its affairs to minimize the impact of the existing personal property taxes.

Application of the Ohio court's decision will have a crippling effect upon both the City of North Royalton and North Royalton City School District Board of Education. The revenues apportioned to each of these taxing districts have already been spent in reasonable reliance upon the belief that each was entitled to the revenues received from the State as a result of the presence of Respondent's equipment in the district. In addition, both tax districts have made significant financial commitments based upon

the reasonable assumption that the revenue would continue at the same level. The fiscal straits confronting local governments and school districts should not be exacerbated by the application of the ill-considered decision of the court below.

CONCLUSION

The Tax Commissioner has rightly and fairly found Respondent to be a telephone company for purposes of personal property tax assessment and apportionment throughout the local taxing districts in the State in which its taxable property is located. These recipients of revenue have relied upon these funds in the development of their budgets and planning to meet public needs in the community. To change retroactively the manner in which these taxes are assessed would be grossly unfair to the local taxing districts which have been the recipient of these funds. To require that these local taxing districts repay any revenues received by them over the past five years, plus interest, ia patently unfair and may lead to financial insolvency at the local level for many districts similarly situated to *amici*.

The application of the Ohio statutes to Respondent, as a facility-based long distance carrier, is reasonable. The statutory scheme in effect for the tax year 1987 recognized the importance of personal property taxes for local governing entities, especially school districts. Any change to this scheme will have devastating results for local governments and school districts. Local governments and

school districts will find it increasingly difficult to prepare budgets in reliance upon the unknown quantity of personal property taxes to be apportioned to the individual district. So long as these taxing entities are reliant upon personal property taxes to the degree they presently rely upon them, any change to the scheme outside the full consideration of the legislative process poses potentially insurmountable difficulties for these entities both in planning to meet and in meeting their public obligations.

The Ohio court below employed an erroneous analysis in reaching its decision. The court failed to consider whether there was any rational basis for the classification of facility-based carriers, it failed to give deference to the classification created by the legislative process in the State, and it failed to consider whether Respondent had suffered any discrimination in fact. As a result of the erroneous application of constitutional principles, *amici* and all similarly situated political subdivisions and school districts will suffer catastrophic financial consequences that will have far-reaching effects throughout Ohio. For these reasons, *amici* respectfully urge this Court to grant the petition for certiorari requested by Petitioner.

Respectfully submitted,

MARK A. ENGEL
(Counsel of Record)
SYLVIA LYNN GILLIS
BRICKER & ECKLER
100 South Third Street
Columbus, OH 43215
(614) 227-2300
Counsel for Amici Curiae

July 7, 1994